SUPREME COURT, U. S.

JAN 9 1974

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-914

GEORGE P. BAKER, RICHARD C. BOND, and JERVIS LANGDON, JR., Trustees of the Property of Penn Central Transportation Company, Debtor,

Petitioners,

v.

INDIANA HARBOR BELT RAILROAD COMPANY, MEMBERS OF THE COMMITTEE OF INTERLINE RAILROADS: THE ATCHISON, TOPEKA AND SANTA FE RAILWAY COMPANY, *et al.*, and LOUISVILLE AND NASHVILLE RAILROAD COMPANY,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION TO THE PETITION

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In the

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No. 73-914

George P. Baker, Richard C. Bond, and Jervis Langdon, Jr., Trustees of the Property of Penn Central Transportation Company, Debtor,

Petitioners,

v.

Indiana Harbor Belt Railroad Company, Members of the Committee of Interline Railroads: The Atchison, Topeka and Santa Fe Railway Company, *et al.*, and Louisville and Nashville Railroad Company,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION TO THE PETITION

Opinion Below

The unanimous opinion of the United States Court of Appeals for the Third Circuit sitting *en banc* is not yet reported. The opinion and amending order are printed in the appendix (A18, A48).

Questions Presented

1. Is this decision, holding that freight and passenger revenues are trust funds and thus not part of the debtor's estate, in conflict with a decision of the Sixth Circuit which dealt solely with the applicability to railroad reorganizations of a statute giving the United States first priority in claims against the estate of an insolvent?

2. Does this decision, which was based exclusively on common law trust principles and thus did not involve the application or construction of Section 77 of the Bankruptcy Act or any other federal statute or rule, present any important question of federal law which should be settled by this Court?

3. Was the Court below correct in finding, through the application of common law trust principles to the accounting rules and regulations of the nation's railroads, that freight and passenger revenues earned by respondent railroads but collected on their behalf by the Penn Central are held in trust?

Statement of the Case

The appeal from the decision of the District Court was argued before three judges of the Court of Appeals for the Third Circuit on April 26, 1973. On May 9, 1973, prior to a decision, the Court *sua sponte* directed that the appeal be reargued before the Court *en banc*. Applying "traditional common law trust principles to the unique regulatory scheme and accounting policies used by the nation's railroads" (A27),* the Court in a 6-0 decision reversed,

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* The following citation form is used: "A" refers to the Appendix to the Petition. "Jt. App." refers to the Joint Appendix filed in the Court of Appeals. "Pet." refers to the Petition for Certiorari.

in part, the order of the District Court and held that freight and passenger revenues earned by respondent railroads* but collected by the Penn Central Transportation Company ("Penn Central") on their behalf are trust funds. It is this part of the decision which petitioners seek to have reviewed.

The case arises against the following background. The interline railroads are required by law to participate in the interstate transportation of freight and passengers and to establish through routes and joint rates. The existence of the national rail transportation system depends upon and could not exist but for this interconnecting rail service (A43-44; see *Southern Ry. Co.* v. *Flournoy*, 301 F.2d 847, 854 (4th Cir. 1962)).

As a result of this compelled relationship, the railroads have established a uniform and elaborate accounting system to facilitate and regularize the collection and distribution of revenues and the apportionment of interline charges. These procedures are embodied in the Accounting Rules of the Association of American Railroads ("AAR Rules") to which the members of that association, including Penn Central and all of the respondents, have agreed and by which they are governed (Jt. App. 69a, 81a).

Only two of the interline accounts established pursuant to these rules are at issue on Penn Central's petition: those relating to the collection of freight and passenger revenues. The salient feature of these two accounts is that all charges for interline freight and passenger transportation are collected by one carrier, regardless of how many intermediate carriers are involved, and thereafter distributed to each participating carrier in proportion to the amount it earned (A25-26).

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* Respondents are the group of railroads ("interline carriers") listed in the Addendum.

(1) Freight Revenues

Every shipper of freight has the right to designate, in the bill of lading, the route of the shipment and the particular carriers which are to participate therein. The total freight charges are fixed by ICC-regulated tariffs which, by application of the established rate "divisions" between the carriers, determine the revenues to be earned by each carrier participating in the shipment. Instead of making separate payments for the freight charges to each of the participating carriers, the shipper or consignee pays all of the freight charges to one carrier; to the origin carrier where the shipment is "prepaid" or to the destination carrier on a "collect" shipment (A25-26; Jt. App. 71a).

The funds collected are deposited in the collecting carrier's general accounts. Because of the vast number of revenue collections which the various carriers make for each other during each month, separate tabulation and segregation of the amounts due the other roads is impossible on any basis shorter than monthly settlements. On the Burlington Northern railroad, for example, in order that interline settlements may ultimately be prepared, agents at more than 1,300 stations must accumulate and transmit, through regional customer accounting centers and on to the company's general offices, the revenue information for each of the hundreds of thousands of monthly shipments (Jt. App. 82a-83a). The Penn Central alone settles with more than 300 carriers (A30).

Under the AAR Rules, the destination carrier on each shipment effects the distribution of the jointly earned revenues pursuant to a monthly settlement. This is done by first preparing an abstract of all revenue waybills, which accompany each separate shipment, to which the established rate divisions are applied (Jt. App. 71-72a). The destination carrier then prepares a series of "summaries" which state the respective payables and receivables between it and each of the other interline carriers

with which it is settling. The summaries and abstracts must be sent by mail or telegram in time to reach the other carriers by the twentieth of the month following the month in which the interline shipments were made. As between two railroads, each strikes a balance based upon the summaries exchanged and the carrier with the net balance in its favor immediately presents a draft for that amount to the other carrier (Jt. App. 72a-74a).

(2) Passenger Revenues

The passenger accounts likewise arise out of the collection by one carrier of transportation charges earned by another and are handled similarly. The monthly reports for these charges are required to be exchanged by the last day of the first month following the performance of the service. Upon the receipt of such reports, net balances are struck and, as with the freight balances, are immediately subject to settlement by draft (A26; Jt. App. 75a).

On Sunday, June 21, 1970, Penn Central petitioned for reorganization. It then declined to honor all drafts presented to it for the payment of interline balances. On July 1, 1970 the Reorganization Court entered an order (Order No. 9) requiring payment by Penn Central of all interline accounts coming due on or after July 1, 1970. That order left open the question of Penn Central's payment of the approximately $33 million in interline accounts which had already come due during the month of June, including approximately $15 million in freight and passenger balances belonging to these respondents (A22-24, 26; Jt. App. 30a (D-3), 32a-33a).

On June 24, 1971 the Trustees petitioned the Reorganization Court for an order directing respondents to pay over to Penn Central the interline balances in the amount of $3.4 million* which had come due in its favor in June

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* The figure given by the Court in its opinion (A24) is a typographical error resulting from transposition of these figures.

1970 but which had been withheld because of Penn Central's refusal to pay the interline balances which it owed respondents for the June settlements. In their answers and counterclaims to this petition, the interline carriers alleged that the freight and passenger revenues collected on their behalf by Penn Central were trust funds and should be paid over to them.

The District Court held that freight and passenger balances were not trust funds, directed that these and the other accounts be paid over to the Penn Central and enjoined any further setoffs (A1-A15). On appeal the Third Circuit *en banc* reversed, in part, the District Court's decision and found that freight and passenger balances were held in trust for the benefit of the carriers performing the services. It further held that the carriers were entitled to offset any amounts* they owed Penn Central against these freight and passenger balances and that they were entitled to be paid the excess of the remaining trust.

In reaching this decision, the court below did no more than apply "traditional common law trust principles" to the "unique regulatory scheme and accounting policies used by the nation's railroads" (A27). While this parochial question is of obvious interest to the parties, it in no way involves an important question of federal law which requires the intervention of this Court. Although the Penn Central seeks to drum up a "conflict" between the Third and Sixth Circuits regarding the nature of freight and passenger balances, there is no such conflict—the Sixth Circuit has simply not decided that question. Further, the decision of the Third Circuit is consistent with statements made by every other circuit court which has had any occasion to consider the character of such interline balances and is correct on the merits.

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* The carriers total offset is estimated at about $7.5 million, consisting of interline balances ($3.4 million) with the remainder miscellaneous accounts.

REASONS FOR DENYING THE WRIT

POINT I

There is no conflict between the decision below and that of any other Circuit Court.

Petitioners have attempted to create the appearance of a conflict between the Third Circuit's decision and an earlier decision of the Sixth Circuit, *In Re Tennessee Central Ry. Co.*, 316 F. Supp. 1103 (M.D. Tenn. 1970), *rev'd*, 463 F.2d 73 (6th Cir. 1972). The decision by the Sixth Circuit, however, had absolutely nothing to do with the question of whether freight and passenger revenues collected by one interline carrier for another are held in trust. The "conflict" is non-existent.

The *Tennessee Central* case originated with a petition by its trustees for a determination of the priority of the various claims filed against the railroad. The government, a creditor therein, claimed a first priority on the basis of Revised Statute 3466 (31 U.S.C. § 191) which gives the government priority in claims against insolvents. The District Court held this statute inapplicable to a railroad reorganization proceeding, and instead accorded a priority to certain railroads, including Penn Central, and other creditors under the so-called "six-months" rule. In passing, the District Court, while noting that the argument had not been raised, stated in *dictum* that the railroad's freight balances were not trust funds, citing the decision in *In Re Central Railroad of New Jersey*, 273 F. Supp. 282 (D.N.J. 1967), *aff'd per curiam*, 392 F.2d 589 (3d Cir. 1968).*

On appeal to the Sixth Circuit, the trust fund issue was not raised. Rather, the sole question before the Sixth

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* The *Jersey Central* decision, insofar as it related to trust funds, was overruled by the Court here (A34).

Circuit was the applicability of R.S. 3466. Citing this Court's decision in *United States* v. *Key*, 397 U.S. 322 (1970), the Sixth Circuit held that R.S. 3466 applied to railroad reorganizations and accordingly reversed the district court and granted the government the priority which it sought.

After the matter was remanded to the Reorganization Court, the railroads there involved sought to have the distribution of the Tennessee Central's assets delayed pending the resolution of the trust fund issue then on appeal to the Third Circuit in this case. Judge Miller (sitting as District Judge by designation) refused to grant the delay, noting that he was bound by the Court of Appeals decision and that:

> "[T]he trust fund theory was not decided by the Court of Appeals, since that issue was not raised . . ." (Memorandum Opinion, p. 4, entered May 24, 1973.)*

Clearly then no issue regarding the status of freight and passenger balances as trust funds has been determined by the Sixth Circuit and there is no conflict thereon.

Penn Central suggests that there is in any event a conflict in "result" between the Third and Sixth Circuit decisions (Pet. 10). Any claimed difference, however, would stem from the fact that different issues were decided by the different courts. There is no conflict between the two decisions. The Sixth Circuit has determined that Revised Statute 3466 is applicable to a railroad reorganization and that the government has first priority among creditors in

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* Judge Miller thereupon directed distribution in accordance with the Sixth Circuit's opinion. The railroads, including Penn Central, have appealed this decision, asserting that they should not be barred, by "law of the case" or laches, from now urging the trust fund issue.

the distribution of the estate. The Third Circuit has determined that freight balances are trust funds, and hence the interline carriers are not creditors at all, but rather beneficiaries of a trust which is not part of the estate. These decisions are perfectly compatible and this Court could affirm both without any conflict.

In terms, there is no lack of uniformity between the two decision, much less "a real and embarrassing conflict of opinion and authority". *Layne & Bowler Corp.* v. *Western Well Works, Inc.*, 261 U.S. 387, 393 (1923).

POINT II

This case involves no important question of federal law.

The question which petitioners seek to have reviewed is whether the Third Circuit was correct in finding that interline freight and passenger revenues collected by one railroad for services performed by another are trust funds rather than ordinary debts. That this in no way involves any question of federal law can be seen by that Court's own characterization of the nature of its determination:

> "Whether the money is held in trust must be determined . . . by application of traditional legal doctrines. We therefore turn to the law of trusts to make that determination." (A27)

After considering the compelled relationship, the huge volume of transactions, the absence of any provision for the payment of interest and the prompt segregation of the revenues upon the determination of their ownership, the Court found that the parties intended a trust relationship to arise (A27-30). Thus:

> "Accommodating and applying traditional common law trust principles to the unique regulatory scheme

> and accounting policies used by the nation's railroads, we have concluded that transportation and freight charges, *when collected,* are held in trust for the Interlines." (A27) [Emphasis in original.]

This is not a determination of a federal question.

It does not help petitioners to observe that the legal status of railroad freight and passenger balances "has never been resolved by this Court" (Pet. 11, 12). There is no reason why it should be. The fact that a given question has not been resolved by the Supreme Court has never been a recognized basis for the grant of certiorari.

Nor does the possibility that this issue might arise in some other pending railroad reorganization require resolution for the "proper administration" of § 77 of the Bankruptcy Act (Pet. 11). In the first place, there is no conflict between the various reorganization courts on this issue nor is there any real likelihood that one will arise.*

Furthermore, the argument that this issue may arise in other reorganizations could be made with respect to virtually any question arising in the course of a reorganization proceeding. Indeed, the Trustees have successfully opposed review in other matters arising out of this reorganization, notwithstanding that the questions involved were obviously of equal applicability to the other pending railroad reorganizations and involved equally substantial sums of money;

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* Although petitioners note that seven other railroad reorganizations are currently pending (Pet. 6), three are in the Third Circuit and will obviously be governed by the decision below. In two others, the trust fund issue never arose since the interline freight balances owed by the bankrupts were simply paid over (Boston & Maine) or were insignificant (Lehigh & Hudson). As to the remaining two reorganizations (the Erie Lackawanna and the Ann Arbor) there is no reason to believe that the reorganization courts, or the Sixth Circuit, if the issue reaches that Court, will not agree with and follow the unanimous decision of the Third Circuit.

moreover, the question in each such proceeding, unlike the question here, was directly related to the interpretation and construction of the bankruptcy laws. *In Re Penn Central Transportation Co.*, 315 F. Supp. 1281 (E.D. Pa. 1970), *aff'd*, 453 F.2d 520 (3d Cir. 1971), *cert. denied*, 408 U.S. 923 (1972) (the *Banks* setoff case); *In Re Penn Central Transportation Co.*, 339 F. Supp. 603 (E.D. Pa. 1972), *aff'd*, 477 F.2d 841 (3d Cir.), *cert. denied*, 42 U.S.L.W. 3213 (No. 72-1698), *aff'd sub nom. U.S. Steel Corp.* v. *Trustees*, 42 U.S.L.W. 3213 (No. 73-94) (U.S. Oct. 15, 1973) (the *Shippers* setoff case); *In Re Penn Central Transportation Co.*, 325 F. Supp. 294 (E.D. Pa. 1970), *aff'd*, 452 F.2d 1107 (3d Cir. 1971), *cert. denied*, 406 U.S. 944 (1972) (the State and Municipal Tax case); see also *In Re Penn Central Transportation Co*, 354 F. Supp. 717 (E.D. Pa. 1972), *rev'd*, 484 F. 2d 323 (3d Cir.), *cert. denied*, 42 U.S.L.W. 3327 (U.S. Dec. 3, 1973) (the Park Avenue Properties case).

In sum, this case involves nothing more than the interpretation and application of common law trust principles. There is no federal question here, important or unimportant, and the fact that the issue may conceivably arise in some other railroad reorganization does not transform a parochial question into a federal one.

POINT III

The Court of Appeals was correct in holding that interline freight and passenger balances collected by one railroad for services performed by another are held in trust.

Contrary to Petitioners' criticisms (Pet. 15), the Third Circuit's decision is both logical and in accord with common law trust principles and is consistent with the statements of all other circuit courts which have had occasion to consider the nature of these revenues.

The Third Circuit summarized the railroad accounting system in the following language:

> "The AAR interline accounting system is in essence, therefore, a system by which one railroad collects monies owed by shippers to both itself and other railroads. The monies collected belong only in part to the collecting railroad; as to monies owed other railroads, the collecting railroad serves merely as a receiving and transmitting agent." (A27)

The Court pointed out that a "common sense interpretation" of this system would be that funds collected by one railroad on behalf of another "are held in trust . . . until the monies are transmitted" (A27). Petitioners seemingly criticize the Court for this application of "common sense", as though it were somehow out of place in a judicial proceeding (Pet. 12-13). But the reasonableness of the holding that a person who "serves merely as a receiving and transmitting agent" for monies belonging to another is a trustee (A27) is fully reinforced by the application of traditional common law trust doctrines.

It is settled that one who collects revenues for another holds them in trust absent a clear showing of a contrary intent. RESTATEMENT (SECOND) OF TRUSTS § 12(h). Thus it has been said that:

> "[W]hen one of two or more joint creditors accepts payment of the obligation, he holds the proceeds as a trustee or agent for them and is directly accountable to them as such." *Cober* v. *Connolly*, 20 Cal.2d 741, 128 P.2d 519, 521 (1942).

The Third Circuit noted this principle and found no such contrary intent here. Of particular significance to the Court was the absence of any provision for the payment of interest by the collecting carrier. As the Court stated:

> "Although not conclusive, its absence indicates the presence of a trust relationship. See *United States* v.

Orsinger, supra; State v. *Atlantic City Electric Co.*, 128 A.2d 861, 865-66 (1957); *State* v. *United States Steel Co., supra.*" (A28)

Petitioners complain of the Court's finding (A29) that commingling of monies has minimal significance as to the parties' intent in the extraordinary operations of interline railroads. Thus they suggest that if a trust were intended, the AAR Rules would have been amended subsequent to the *Jersey Central* case, *supra*, so as to "require segregation of the funds collected" or "bar the collecting carrier's use of the funds" (Pet. 13). No such amendment was possible, however. As the Third Circuit pointed out, an immediate segregation of freight and passenger revenues is not even remotely feasible:

> "Normal operation conditions with innumerable daily collections of various categories preclude practically and economically any effective daily segregation. Burlington Northern Railway alone has more than 1300 stations from which waybills are issued. This is not a simple situation of one party receiving money clearly designated as payment for services performed by another. When a carrier collects funds for another railroad, it does not immediately know what portion of the revenues collected is to be allocated to other carriers." (A29-30)

It is equally impossible to prohibit the collecting carrier's use of the funds collected until such time as the segregation can be accomplished, since an indeterminate amount also represents earnings belonging to that carrier. It is important to note, however, that as soon as the monthly statements are rendered and ownership of the various revenues is thereby determined—which is the earliest point at which the funds could conceivably be "segregated"—the net balance due to any given carrier is subject to an immediate draft (A26; Jt. App. 73a-74a). This is a clear manifestation of the parties' intention that the revenues be treated as trust funds.

Petitioners suggest that the railroads include in their settlements all freight charges for transportation within the previous month regardless of whether the charges have actually been collected and that, to the extent of this difference, there is no "corpus" on which to impress a trust (Pet. 14-15). The extension of credit beyond 120 hours after delivery is, however, prohibited. Interstate Commerce Act § 3(2), 49 U.S.C. § 3(2); ICC Order No. 73, 49 CFR § 16(e); Jt. App. 84a. Since the monthly statements are not presented until the 20th of the month following delivery, it is obvious that the parties intended that outstanding charges would be paid and the trust corpus in existence by that time.

Petitioners also complain that the Court did not follow Judge Augelli's decision in *In Re Central Railroad of New Jersey,* 273 F. Supp. 282 (D.N.J. 1967), which had been affirmed *per curiam* by a panel of the Third Circuit, 392 F.2d 589 (1968). The only significance of this is that the entire Court, after full consideration of the question, disagreed with Judge Augelli. This was its right and patently furnishes no basis for seeking review by this Court.

Finally, it should be noted that the Third Circuit's holding is consistent with the view of every other circuit court which has had any occasion to consider the status of these revenues. *Southern Ry Co.* v. *United States,* 306 F.2d 119, 125 (5th Cir. 1962); *Thompson* v. *B&O R. Co.,* 80 F. Supp. 570, 586 (E.D. Mo. 1948), *aff'd,* 180 F.2d 416, 420-421 (8th Cir. 1950); *Accord, Atlantic Coast Line R. Co.* v. *Penn R. Co.,* 12 F. Supp. 720, 722-723 (E.D. Pa. 1935). See also *In Re Chicago Express, Inc.,* 222 F.Supp. 566, 572 (S.D.N.Y. 1963), *aff'd,* 332 F.2d 276 (2d Cir.), *cert. denied,* 379 U.S. 879 (1964); *Morgenthau* v. *Sugar Land Ry. Co.,* 83 F.2d 72, 74 (5th Cir. 1936). Representative is *Southern Ry. Co., supra,* where the court stated that:

> "The Receiver had a right to collect and to retain. The duty to remit was limited to the balance when and as struck in the periodic settlements. Only then did funds,

rightfully collected and mingled, acquire a 'trust' character." 306 F.2d at 125.

The opinion below thus represents a reasoned application of common law principles of trust and equity to the complex railroad accounting system and is, we submit, eminently correct.

CONCLUSION

For each of the foregoing reasons the Trustees' Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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ADDENDUM

Respondents

The Atchison, Topeka and Santa Fe Railway Company
    Illinois Northern, Inc.
    Illinois Northern Railway
Burlington Northern, Inc.
    Oregon Trunk Railway
Chicago, Milwaukee, St. Paul and Pacific Railroad Company
Chicago, Rock Island & Pacific Railroad Co.
    Peoria Terminal Co.
Delaware & Hudson Railway Co.
    Greenwich & Johnsonville Railway Co.
Indiana Harbor Belt Railroad Company
Kansas City Southern Railroad
    Louisiana & Arkansas Railway Co.
Louisville and Nashville Railroad Company
Missouri-Kansas-Texas Railroad Co.
Missouri Pacific Railroad Co.
    Texas & Pacific Railway Co.
    Missouri-Illinois Railroad Co.
    Chicago & Eastern Illinois Railroad
Norfolk and Western Railway Co.
    New Jersey, Indiana & Illinois Railroad
    Norfolk, Franklin & Danville Railway
Seaboard Coast Line Railroad Co.
    Columbia, Newberry & Laurens Railroad Co.
Southern Pacific Transportation Company
    San Diego & Arizona Eastern Railway
    Northwestern Pacific RR
    Portland Traction Company
    Sunset Railway Co.
    Visalia Electric Railroad Co.
    St. Louis Southwestern Railway Co.
Southern Railway System
Union Pacific Railroad Co.
The Western Pacific Railroad Co.
    Sacramento Northern Railway